Changes to the text of Regulation Sections 23038(a), 23038(b)-1, 23038(b)-2 and 23038(b) as noticed in the California Regulatory Notice Register on August 1, 1997 are shown in double underscore of the new text and strikeout and bold of the original text.

Regulation 23038(a) is amended.

§ 23038(a). **"Corporation" Defined.--** (1) Scope of Definition. The term "corporation" applies to all corporations, ~~other than banks and~~ other than corporations specifically exempt under Article 1, Chapter 4, or under the provisions of Article XIII of the Constitution of the State of California. Corporations *and limited liability companies* ***~~that are~~*** *classified as an association for California* income and franchise *tax purposes* which are qualified to do or are "doing business" in this State, and domestic corporations not otherwise taxed under this part, are subject to the tax imposed under Chapter 2. See *Sections 23038 and 23151-23155 of the Revenue and Taxation Code* and Reg. ~~23151--23154~~*§23151*. Unless specifically exempted, foreign corporations engaged exclusively in interstate commerce, holding companies and unincorporated associations (other than limited liability companies) are subject to the tax imposed under Chapter 3 on income derived from sources within this State. See Reg. ~~23501--23504~~ *§23501 and Reg. §23504.*

*Generally, banks* ~~Banks~~ are ~~specifically excluded from~~ *included in* the definition of "corporation~~.~~," *but they* ~~They~~ are taxable in a different manner. The law contains special provisions for determining and computing the rate *and applicable provisions.*

(2) Corporations Under Chapter 3. For the purpose of the tax imposed under Chapter 3 the term "corporation" is not limited to incorporated bodies, nor does it include all incorporated bodies. *Banking* ~~Banks and banking~~ associations are excluded from the meaning of the term, and associations, ~~Massachusetts trusts and~~ business trusts, *and other business entities classified as associations under Regulation §23038(b)-1 to §23038(b)-3* are included in its meaning.

~~The term "association" is not used in the law in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is similar to an ordinary corporation.~~

*(3)(A) Ordinary trusts. In general, the* ~~The~~ term "trust," as used in the Personal Income Tax Law, refers to an *arrangement* ~~ordinary trust (as distinguished from a business trust), namely, one~~ created by *a* will or by *an* ***~~intervivos~~*** *inter vivos* declaration ~~of the trustees or~~

~~the grantor, the~~ *whereby* trustees ~~of which~~ take title to the property for the purpose of protecting or conserving it *for the beneficiaries* ~~as customarily required~~ under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. *However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Revenue and Taxation Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Revenue and Taxation Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.* ~~**Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.**~~

*(B) Business trusts. There are arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of beneficiaries, but which are not classified as trusts for purposes of the Revenue and Taxation Code because they are not simply arrangements to protect or conserve the property for beneficiaries. These trusts, which are often known as business or commercial trusts, generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Revenue and Taxation Code. However, the fact that the corpus of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than an association or a partnership. The fact that any organization is technically cast in the trust form, by conveying title to property to trustees for the benefit of persons designated as beneficiaries, will not change the real character of the organization if the organization is more properly classified as a business entity under Reg.~~***~~***ulation*** §*23038(b)-2.*

*(C) Certain investment trusts.* An "investment" trust will not be classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders. An investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets of the trust, will be classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders. An investment trust with multiple classes of ownership interests will ordinarily be classified as an association or a partnership under Reg.~~***ulation*** §~~23038(b)-*3;* however, an investment trust with multiple classes of ownership interests, in which there is no power under the trust agreement to vary the investment of the certificate holders, will be classified as a trust if the trust is formed to facilitate direct investment in the assets of the trust and the existence of multiple classes of ownership interests is incidental to that purpose.

*(D) Liquidating trusts. Certain organizations which are commonly known as liquidating trusts are treated as trusts for purposes of the Revenue and Taxation* ~~*Revenue*~~ *Code. An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose. A liquidating trust is treated as a trust for purposes of the Revenue and Taxation Code because it is formed with the objective of liquidating particular assets and not as an organization having as its purpose the carrying on of a profit-making business which normally would be conducted through business organizations classified as corporations or partnerships. However, if the liquidation is unreasonably prolonged or if the liquidation purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust. Bondholders' protective committees, voting trusts, and other agencies formed to protect the interests of security holders during insolvency, bankruptcy, or corporate reorganization proceedings are analogous to liquidating trusts, but if subsequently utilized to further the control or profitable operation of a going business on a permanent continuing basis, they will lose their classification as trusts for purposes of the Revenue and Taxation Code.*

*(E) Environmental remediation trusts. 1. An environmental remediation trust is considered a trust for purposes of the Revenue and Taxation Code. For purposes of this subsection (E), an organization is an environmental remediation trust if the organization is organized under state law as a trust; the primary purpose of the trust is collecting and disbursing amounts for environmental remediation of an existing waste site to resolve, satisfy, mitigate, address, or prevent the liability or potential liability of persons imposed by federal, state, or local environmental laws; all contributors to the trust have (at the time of contribution and thereafter) actual or potential liability or a reasonable expectation of liability under federal, state, or local environmental laws for environmental remediation of the waste site; and the trust is not a qualified settlement fund within the meaning of Treas. Reg. §1.468B-1(a), as applicable for California* income and franchise *tax purposes pursuant to Sections 23051.5 and 24693 of the Revenue and Taxation Code. An environmental remediation trust is classified as a trust because its primary purpose is environmental remediation of an existing waste site and not the carrying on of a profit-making business that normally would be conducted through business organizations classified as corporations or partnerships. However, if the remedial purpose is altered or becomes so obscured by business or investment activities that the declared remedial purpose is no longer controlling, the organization will no longer be classified as a trust. For purposes of this subsection (E), environmental remediation includes the costs of assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, and collecting amounts from persons liable or potentially liable for the costs of these activities. For purposes of this subsection (E), persons have potential liability or a reasonable expectation of liability under federal, state, or local environmental laws for remediation of the existing waste site if there is authority under a federal, state, or local law that requires or could*

*reasonably be expected to require such persons to satisfy all or a portion of the costs of the environmental remediation.*

*2. Each contributor (grantor) to the trust is treated as the owner of the portion of the trust contributed by that grantor under rules provided in* ~~*s*~~ *Section 677 of the Internal Revenue Code and Treas. Reg. §1.677(a)-1(d), as applicable for California* income and franchise *tax purposes pursuant to Sections 17024.5 and 17731 of the Revenue and Taxation Code. Section 677 of the Internal Revenue Code and Treas. Reg. §1.677(a)-1(d) provide rules regarding the treatment of a grantor as the owner of a portion of a trust applied in discharge of the grantor's legal obligation. Items of income, deduction, and credit attributable to an environmental remediation trust are not reported by the trust on California* income tax return of the trust (*Form 541* or any successor form)*, but are shown on a separate statement to be attached to that form. See Treas. Reg. §1.671-4(a). The trustee must also furnish to each grantor a statement that shows all items of income, deduction, and credit of the trust for the grantor's taxable year attributable to the portion of the trust treated as owned by the grantor. The statement must provide the grantor with the information necessary to take the items into account in computing the grantor's taxable income, including information necessary to determine the federal tax treatment of the items (for example, whether an item is a deductible expense under* ~~*s*~~ *Section 162(a) of the Internal Revenue Code, as applicable for California* income and franchise *tax purposes, or a capital expenditure under* ~~*s*~~ *Section 263(a) of the Internal Revenue Code, as applicable for California* income and franchise *tax purposes) and how the item should be taken into account under the economic performance rules of* ~~*s*~~ *Section 461(h) of the Internal Revenue Code and the regulations thereunder, as applicable for California* income and franchise *tax purposes pursuant to Sections 17024.5, 17551, 23051.5, and 24681 of the Revenue and Taxation Code. See Treas. Reg. §1.461-4 for rules relating to economic performance.*

*3. All amounts contributed to an environmental remediation trust by a grantor (cash-out grantor) who, pursuant to an agreement with the other grantors, contributes a fixed amount to the trust and is relieved by the other grantors of any further obligation to make contributions to the trust, but remains liable or potentially liable under the applicable environmental laws, will be considered amounts contributed for remediation. An environmental remediation trust agreement may direct the trustee to expend amounts contributed by a cash-out grantor (and the earnings thereon) before expending amounts contributed by other grantors (and the earnings thereon). A cash-out grantor will cease to be treated as an owner of a portion of the trust when the grantor's portion is fully expended by the trust.*

~~As distinguished from the ordinary trust described herein, there is an arrangement whereby the legal title to property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profitseeking activity may be carried on through a substitute for an organization such as a voluntary association, a joint-stock company, a corporation, or a partnership, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not~~

be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association or partnership, and the undertaking or arrangement is deemed to be either an association classified by the law as a corporation or a partnership.

However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association or a partnership.

By means of the trust form, the disadvantages of an ordinary partnership are avoided. For instance, the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. The trust form affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation or a partnership. The trust form also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the issuance of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "Charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself. The law disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

(3) Business Trusts. The law includes, in the term "corporation," organizations known as Massachusetts or business trusts. Generally, trusts of this type are also included within the term "association," but there are instances where these trusts are taxable even

though they are not associations. The power of the trustee(s) to vary the investment of the certificate holders, directly or indirectly, shall be a determining factor for purposes of characterizing an enterprise as a business trust.

Any trust in which the trustee or trustees have the power to vary the investment of the certificate holders shall be classified as a business trust, unless one of the following exceptions apply: (1) A trust which otherwise qualifies as a partnership pursuant to Regulation Section 23038(b) and which meets the asset and gross income requirements of Section 17955(c)(1)(A) and (B) of the Revenue and Taxation Code for an investment partnership shall be characterized for purposes of taxation as a partnership under California law; or (B) The trust is classified as a partnership under Regulation Section 23038(b), but in applying that regulation, the existence of a power to vary investments shall be deemed an additional corporate characteristic.

It is not essential to the existence of a Massachusetts or business trust that the beneficiaries enjoy limited liability or that the trust be established by them. A testamentary trust may be a Massachusetts or business trust under the law if the trust is an active business enterprise instead of a trust to conserve assets or invest and reinvest securities.

Trusts which are outwardly business trusts but are actually using the trust device as a security measure rather than primarily to facilitate the operation of a business are not treated as business trusts if the primary purpose in the use of the trust device was for security rather than to facilitate the operation of a subdivision business with the trustee exercising some discretionary powers.

Bondholders' committees may be business trusts if they operate business properties.

Negotiable certificates of beneficial interest are not necessary to a business trust. Permanent existence need not be contemplated, nor is it required that there be more than one trustee or more than one beneficiary if the other requirements are satisfied.

The declaration of trust or other trust instrument and the provisions therein are conclusive of the character of the trust as a business trust or otherwise. Facts not mentioned therein need not be examined.

(4) Examples. The application of the rules described in this regulation are illustrated by the following examples:

EXAMPLE (A). An organization formed in the State of Delaware is organized with centralized management and continuity of life, but does not limit the liability of its members and does not have free transferability of interests of its members. Its operational rules permit the trustee discretion to vary the investments of the organization. If the organization meets the asset and gross income requirements for an investment partnership set forth in Section 17955(c)(1)(A) and (B) of the Revenue and Taxation Code, the organization will qualify for treatment as a partnership under Regulation Section 23038(b) because it does not more nearly resemble a corporation.

EXAMPLE (B). Assume the same facts as in Example (A) except that the organization does not meet the definitional requirements as an investment partnership. The organization will be classified as a corporation because it has more indicia of a corporation (discretion, centralized management and continuity of life) than of a partnership.

EXAMPLE (C). Assume the same facts as in Example (B) except that the organization does not have continuity of life. The organization will be classified as a

~~partnership under Regulation Section 23038(b) because it does not more nearly resemble a corporation.~~

~~(5) Partnerships. A limited partnership is classified for the purpose of the law as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.~~

~~The revised Uniform Limited Partnership Act has been adopted in several states, including California. A limited partnership organized under the provisions of that act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.~~

~~Effective Date: This regulation applies to taxable or income years beginning on or after January 1, 1993.~~

Effective Date: This regulation applies to taxable or income years beginning on or after January 1, 1997.

Note: Authority cited: Sections 19503 *and 23038,* Revenue and Taxation Code Reference: Sections *17024.5, 17551, 17731,* 17954, ~~17955,~~ 23038, 23040, ~~23040.1,~~ *23051.5,* 24651, 24667, 24668.1, 24672, 24673, *24681, and 24693,* Revenue and Taxation Code.

Regulation 23038(b)-1 is adopted to read:

***§ 23038(b)-1. Classification of organizations for California* income and franchise *tax purposes.***

*(a) Organizations for California* income and franchise *tax purposes--(1) In general. The Revenue and Taxation Code prescribes the classification of various organizations for California* income and franchise *tax purposes. Whether an organization is an entity separate from its owners for California* income and franchise *tax purposes is a matter of California* income and franchise *tax law and does not depend on whether the organization is recognized as an entity under local law.*

*(2) Certain joint undertakings give rise to entities for California* income and franchise *tax purposes. A joint venture or other contractual arrangement may create a separate entity for California* income and franchise *tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. For example, a separate entity exists for California* income and franchise *tax purposes if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent. Nevertheless, a joint undertaking merely to share expenses does not create a separate entity for California* income and franchise *tax purposes. For example, if two or more persons jointly construct a ditch merely to drain surface water from their properties, they have not created a separate entity for*

*California* income and franchise *tax purposes. Similarly, mere co-ownership of property that is maintained, kept in repair, and rented or leased does not constitute a separate entity for California* income and franchise *tax purposes. For example, if an individual owner, or tenants in common, of farm property lease it to a farmer for a cash rental or a share of the crops, they do not necessarily create a separate entity for California* income and franchise *tax purposes.*

*(3) Certain local law entities not recognized. An entity formed under local law is not always recognized as a separate entity for California* income and franchise *tax purposes. For example, an organization wholly owned by a* ~~S~~s*tate is not recognized as a separate entity for California* income and franchise *tax purposes if it is an integral part of the* ~~s~~S*tate. Similarly, tribes incorporated under section 17 of the Indian Reorganization Act of 1934, as amended, 25 U.S.C. §477, or under section 3 of the Oklahoma Indian Welfare Act, as amended, 25 U.S.C. §503, are not recognized as separate entities for California* income and franchise *tax purposes.*

*(4) Single owner organizations. Under Regs.* §*23038(b)-2 and* §*23038(b)-3, certain organizations that have a single owner can choose to be recognized or disregarded as entities separate from their owners, subject to certain statutory provisions which recognize the existence of otherwise disregarded entities for certain purposes including the tax and fee of a limited liability company under Sections 17941 and 17942 of the Revenue and Taxation Code, the return filing requirements* of a limited liability company *under Section 18633.5 of the Revenue and Taxation Code, and the credit limitations* of a disregarded entity *under Sections 17039 and 23036 of the Revenue and Taxation Code.*

*(b) Classification of organizations. The classification of organizations that are recognized as separate entities is determined under Regs.* §*23038(b)-2,* §*23038(b)-3, and* §*23038(a)(3) unless a provision of the Revenue and Taxation Code (such as section 860A of the Internal Revenue Code addressing Real Estate Mortgage Investment Conduits (REMICs), as applicable for California purposes pursuant to section 24870 of the Revenue and Taxation Code) provides for special treatment of that organization. For the classification of organizations as trusts, see Reg. §23038(a)(3). That regulation provides that trusts generally do not have associates or an objective to carry on business for profit. Regulations §23038(b)-2 and §23038(b)-3 provide rules for classifying organizations that are not classified as trusts.*

*(c) Qualified cost sharing arrangements. A qualified cost sharing arrangement that is described in Treas. Regs.* ~~*Sec.*~~ §*1.482-7 and any arrangement that is treated by the Commissioner as a qualified cost sharing arrangement under Treas. Regs* ~~*Sec.*~~ §*1.482-7, as applicable for California* income and franchise *tax purposes pursuant to Sections 23051.5 and 24725 of the* ~~r~~ R*evenue and Taxation Code (except as provided in Article 1.5 of* ~~c~~C*hapter 17 of the Bank and Corporation Tax Law, commencing with* ~~s~~S*ection 25101 of the Revenue and Taxation Code), is not recognized as a separate entity for purposes of the Revenue and Taxation Code. See Treas. Regs* ~~*Sec.*~~ §*1.482-7 for the proper treatment of qualified cost sharing arrangements.*

*(d) Domestic and foreign entities. For purposes of this regulation and Regs. §23038(b)-2 and §23038(b)-3, an entity is a domestic entity if it is created or organized*

*in the United States or under the law of the United States or of any* ~~*S*~~s*tate; an entity is foreign if it is not domestic.*

*(e) State. For purposes of this regulation and Reg. §23038(b)-2, the term* ~~*S*~~s*tate includes the District of Columbia.*

*(f) Effective date.* ~~***The rules of t***~~ T*his regulation* ~~***are***~~ is *effective for taxable or income years commencing on or after January 1, 1997.*~~***, provided, however, that none of the rules of this regulation shall apply until the effective date of SB 1234 (1997 Regular Session), as enacted.***~~

*Note: Authority cited: Sections 19503 and 23038, Revenue and Taxation Code. Reference: Sections 17039, 17941, 18633.5, 23036, and 23038, Revenue and Taxation Code.*

Regulation 23038(b)-2 is adopted to read:

***§ 23038(b)-2 Business entities; definitions.***

*(a) Business entities. For purposes of this regulation and Reg. §23038(b)-3, a business entity is any entity recognized for California* income and franchise *tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under Reg. §23038(b)-3) that is not properly classified as a trust under Reg. §23038(a)(3) or otherwise subject to special treatment under the Revenue and Taxation Code. A business entity with two or more members is classified for California* income and franchise *tax purposes as either a corporation or a partnership. A business entity with only one owner is classified as an association taxable as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.*

*(b) Corporations. For purposes of the tax imposed under Chapter 3 of the Revenue and Taxation Code (commencing with Section 23501), the term corporation* ~~***means***~~ includes--

*(1) A business entity organized under a federal or* ~~*S*~~*state statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic;*

*(2) An association (as determined under Reg. §23038(b)-3);*

*(3) A business entity organized under a* ~~*S*~~s*tate statute, if the statute describes or refers to the entity as a joint-stock company or joint-stock association;*

*(4) [reserved];*

*(5) [reserved];*

*(6) [reserved];*

*(7) A business entity that is taxable as a corporation under a provision of the Revenue and Taxation Code other than subdivision (b) of* ~~*s*~~S*ection 23038; and*

*(8) Certain foreign entities--(A) In general. Except as provided in subsections (b)(8)(B) and (d) of this regulation, the following business entities formed in the following jurisdictions:*

*American Samoa, Corporation*
*Argentina, Sociedad Anonima*
*Australia, Public Limited Company*
*Austria, Aktiengesellschaft*
*Barbados, Limited Company*
*Belgium, Societe Anonyme*
*Belize, Public Limited Company*
*Bolivia, Sociedad Anonima*
*Brazil, Sociedade Anonima*
*Canada, Corporation and Company*
*Chile, Sociedad Anonima*
*People's Republic of China, Gufen Youxian Gongsi*
*Republic of China (Taiwan), Ku-fen Yu-hsien Kung-szu*
*Colombia, Sociedad Anonima*
*Costa Rica, Sociedad Anonima*
*Cyprus, Public Limited Company*
*Czech Republic, Akciova Spolecnost*
*Denmark, Aktieselskab*
*Ecuador, Sociedad Anonima or Compania Anonima*
*Egypt, Sharikat Al-Mossahamah*
*El Salvador, Sociedad Anonima*
*Finland, Osakeyhtio/Aktiebolag*
*France, Societe Anonyme*
*Germany, Aktiengesellschaft*
*Greece, Anonymos Etairia*
*Guam, Corporation*
*Guatemala, Sociedad Anonima*
*Guyana, Public Limited Company*
*Honduras, Sociedad Anonima*
*Hong Kong, Public Limited Company*
*Hungary, Reszvenytarsasag*
*Iceland, Hlutafelag*
*India, Public Limited Company*
*Indonesia, Perseroan Terbuka*
*Ireland, Public Limited Company*
*Israel, Public Limited Company*
*Italy, Societa per Azioni*
*Jamaica, Public Limited Company*
*Japan, Kabushiki Kaisha*
*Kazakstan, Ashyk Aktsionerlik Kogham*
*Republic of Korea, Chusik Hoesa*
*Liberia, Corporation*
*Luxembourg, Societe Anonyme*
*Malaysia, Berhad*

*Malta, Partnership Anonyme*
*Mexico, Sociedad Anonima*
*Morocco, Societe Anonyme*
*Netherlands, Naamloze Vennootschap*
*New Zealand, Limited Company*
*Nicaragua, Compania Anonima*
*Nigeria, Public Limited Company*
*Northern Mariana Islands, Corporation*
*Norway, Aksjeselskap*
*Pakistan, Public Limited Company*
*Panama, Sociedad Anonima*
*Paraguay, Sociedad Anonima*
*Peru, Sociedad Anonima*
*Philippines, Stock Corporation*
*Poland, Spolka Akcyjna*
*Portugal, Sociedade Anonima*
*Puerto Rico, Corporation*
*Romania, Societe pe Actiuni*
*Russia, Otkrytoye Aktsionernoy Obshchestvo*
*Saudi Arabia, Sharikat Al-Mossahamah*
*Singapore, Public Limited Company*
*Slovak Republic, Akciova Spolocnost*
*South Africa, Public Limited Company*
*Spain, Sociedad Anonima*
*Surinam, Naamloze Vennootschap*
*Sweden, Publika Aktiebolag*
*Switzerland, Aktiengesellschaft*
*Thailand, Borisat Chamkad (Mahachon)*
*Trinidad and Tobago, Public Limited Company*
*Tunisia, Societe Anonyme*
*Turkey, Anonim Sirket*
*Ukraine, Aktsionerne Tovaristvo Vidkritogo Tipu*
*United Kingdom, Public Limited Company*
*United States Virgin Islands, Corporation*
*Uruguay, Sociedad Anonima*
*Venezuela, Sociedad Anonima or Compania Anonima*

*(B) Exceptions in certain cases. The following entities will not be treated as corporations under subsection (b)(8)(A) of this regulation:*

*1. With regard to Canada, any corporation or company formed under any federal or provincial law which provides that the liability of all of the members of such corporation or company will be unlimited; and*

*2. With regard to India, a company deemed to be a public limited company solely by operation of Section 43A(1) (relating to corporate ownership of the company), **s**Section 43A(1A) (relating to annual average turnover), or **s**Section 43A(1B) (relating to*

*ownership interests in other companies) of the Companies Act, 1956 (or any combination of these), provided that the organizational documents of such deemed public limited company continue to meet the requirements of ~~s~~Section 3(1)(iii) of the Companies Act, 1956.*

*(C) Public companies. With regard to Cyprus, Hong Kong, Jamaica, and Trinidad and Tobago, the term public limited company includes any limited company which is not a private limited company under the laws of those jurisdictions.*

*(D) Limited companies. Any reference to a limited company (whether public or private) in subsection (b)(8)(A) of this regulation includes, as the case may be, companies limited by shares and companies limited by guarantee.*

*(E) Multilingual countries. Different linguistic renderings of the name of an entity listed in subsection (b)(8)(A) of this regulation shall be disregarded. For example, an entity formed under the laws of Switzerland as a Societe Anonyme will be a corporation and treated in the same manner as an Aktiengesellschaft.*

*(c) Other business entities. (1) For California* income and franchise *tax purposes, the term partnership means a business entity that is not a corporation under subsection (b) of this regulation and that has at least two members.*

*(2) Wholly owned entities--(A) In general. A business entity that has a single owner and is not a corporation under subsection (b) of this regulation is disregarded as an entity separate from its owner for purposes of Part 10 (Personal Income Tax Law commencing with ~~s~~Section 17001), Part 10.2 (Administration of ~~f~~Franchise and Income Tax Law commencing with ~~s~~Section 18401), and Part 11 (Bank and Corporation Tax Law commencing with ~~s~~Section 23001) of the Revenue and Taxation Code, subject to certain statutory provisions which recognize the existence of otherwise disregarded entities for certain purposes including the tax and fee of a limited liability company under Sections 17941 and 17942 of the Revenue and Taxation Code, the return filing requirements* of a limited liability company *under Section 18633.5 of the Revenue and Taxation Code, and the credit limitations* of a disregarded entity *under Sections 17039 and 23036 of the Revenue and Taxation Code.*

*(B) Special rule for certain business entities. If the single owner of a business entity is a bank (as defined in ~~s~~Section 23039 of the Revenue and Taxation Code), then the special rules applicable to banks will continue to apply to the single owner as if the wholly owned entity were a separate entity.*

*(d) Special rule for certain foreign business entities--(1) In general. Except as provided in subsection (d)(3) of this regulation, a foreign business entity described in subsection (b)(8)(A) of this regulation will not be treated as a corporation under subsection (b)(8)(A) of this regulation if--*

*(A) The entity was in existence on May 8, 1996;*

*(B) The entity's classification was relevant (as defined in Reg. §23038(b)-3(d)) on May 8, 1996;*

*(C) No person (including the entity) for whom the entity's classification was relevant on May 8, 1996, treats the entity as a corporation for purposes of filing such person's California income tax returns, information returns, and withholding documents for the taxable year including May 8, 1996;*

*(D) Any change in the entity's claimed classification within the sixty months prior to May 8, 1996, occurred solely as a result of a change in the organizational documents of the entity, and the entity and all members of the entity recognized the California* income *tax consequences of any change in the entity's classification within the sixty months prior to May 8, 1996;*

*(E) A reasonable basis (within the meaning of* ~~s~~S*ection 6662 of the Internal Revenue Code) existed on May 8, 1996, for treating the entity as other than a corporation; and*

*(F) Neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination (in which case the entity's classification will be determined in the examination).*

*(2) Binding contract rule. If a foreign business entity described in subsection (b)(8)(A) of this regulation is formed after May 8, 1996, pursuant to a written binding contract (including an accepted bid to develop a project) in effect on May 8, 1996, and* at *all times thereafter, in which the parties agreed to engage (directly or indirectly) in an active and substantial business operation in the jurisdiction in which the entity is formed, subsection (d)(1) of this regulation will be applied to that entity by substituting the date of the entity's formation for May 8, 1996.*

*(3) Termination of grandfather status--(A) In general. An entity that is not treated as a corporation under subsection (b)(8)(A) of this regulation by reason of subsection (d)(1) or (d)(2) of this regulation will be treated permanently as a corporation under subsection (b)(8)(A) of this regulation from the earliest of:*

*1. The effective date of an election to be treated as an association under Reg. §23038(b)-3;*

*2. A termination of the partnership under* ~~s~~S*ection 708(b)(1)(B) of the Internal Revenue Code (regarding sale or exchange of 50 percent or more of the total interest in an entity's capital or profits within a twelve month period); or*

*3. A division of the partnership under* ~~s~~S*ection 708(b)(2)(B) of the Internal Revenue Code.*

*(B) Special rule for certain entities. For purposes of subsection (d)(2) of this regulation, subsection (d)(3)(A)2. of this regulation shall not apply if the sale or exchange of interests in the entity is to a related person (within the meaning of* ~~s~~S*ections 267(b) and 707(b) of the Internal Revenue Code) and occurs no later than twelve months after the date of the formation of the entity.*

~~***(f)***~~ (e) *Effective date. The rules of this regulation are effective for taxable or income years commencing on or after January 1, 1997.* ~~***, provided, however, that none of the rules of this regulation shall apply until the effective date of SB 1234 (1997 Regular Session), as enacted.***~~

*Note: Authority cited: Sections 19503 and 23038, Revenue and Taxation Code. Reference: Sections 17039, 17941, 18633.5, 23036, and 23038, Revenue and Taxation Code.*

Regulation 23038(b)-3 is adopted to read:

***§ 23038(b)-3 Classification of certain business entities****.*

*(a) In general. A business entity that is not classified as a corporation under Reg. §23038(b)-2(b) (1), (3), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in Treas. Regs* ~~***Sec.***~~ §*301.7701-3. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under Reg. §23038-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner. Paragraph (b) of Treas. Regs.* ~~***Sec.***~~ §*301.7701-3 provides a default classification for an eligible entity that does not make an election. Thus, federal elections are necessary only when an eligible entity chooses to be classified initially as other than the default classification or when an eligible entity chooses to change its classification. An entity whose classification is determined under the default classification retains that classification (regardless of any changes in the members' liability that occurs at any time during the time that the entity's classification is relevant as defined in subsection (d) of this regulation) until the entity makes an election to change that classification under paragraph (c)(1) of Treas. Regs.* ~~***Sec.***~~ §*301.7701-3. Paragraph (c) of Treas. Regs.* ~~***Sec.***~~ §*301.7701-3 provides rules for making express elections. Subsection (c) of this regulation provides that for purposes of the taxes imposed by Part 11 of the Revenue and Taxation Code*~~*, the***~~ (*Bank and Corporation Tax Law*~~*,***~~ ~~*(*~~*commencing with* ~~*s*~~Section 23001)~~*,***~~ *the classification of an eligible business entity shall be the same as the classification of the entity for federal purposes and that if the separate existence of a business entity is disregarded for federal tax purposes, the separate existence of that business entity shall be disregarded. No separate election is allowed. Subsection (d) of this regulation provides special rules for foreign eligible entities. Subsection (e) of this regulation provides special rules for classifying entities resulting from partnership terminations and divisions under* ~~*s*~~Section *708(b) of the Internal Revenue Code. Subsection (f) of this regulation sets forth the effective date of this regulation and a special rule relating to prior periods.*

*(b) Classification of eligible entities that do not file an election--(1) Domestic eligible entities. Except as provided in subsection (b)(3) of this regulation, unless the entity elects otherwise, a domestic eligible entity is* ~~*--*~~

~~***1.***~~ (A) *A partnership if it has two or more members; or*

~~***2.***~~ (B) *Disregarded as an entity separate from its owner if it has a single owner.*

*(2) Foreign eligible entities--(A) In general. Except as provided in subsection (b)(3) of this regulation, unless the entity elects otherwise, a foreign eligible entity is--*

*1. A partnership if it has two or more members and at least one member does not have limited liability;*

*2. An association if all members have limited liability; or*

*3. Disregarded as an entity separate from its owner if it has a single owner that does not have limited liability.*

*(B) Definition of limited liability. For purposes of subsection (b)(2)(A) of this regulation, a member of a foreign eligible entity has limited liability if the member has no personal liability for the debts of or claims against the entity by reason of being a member. This determination is based solely on the statute or law pursuant to which the*

*entity is organized, except that if the underlying statute or law allows the entity to specify in its organizational documents whether the members will have limited liability, the organizational documents may also be relevant. For purposes of this regulation, a member has personal liability if the creditors of the entity may seek satisfaction of all or any portion of the debts or claims against the entity from the member as such. A member has personal liability for purposes of this subsection even if the member makes an agreement under which another person (whether or not a member of the entity) assumes such liability or agrees to indemnify that member for any such liability.*

*(3) Federal classification of existing eligible entities. (A) In general. Unless the entity elects otherwise, an eligible entity in existence prior to the effective date of this regulation will have the same classification for federal purposes that the entity claimed under repealed Treas. Reg.* ~~***Secs.***~~ §§*301.7701-1 through 301.7701-3 as in effect on the date prior to the effective date of this regulation; except that if an eligible entity with a single owner claimed to be a partnership under those regulations, the entity will be disregarded as an entity separate from its owner under this subsection (b)(3)(A) for federal tax purposes. For special rules regarding the classification of such entities for periods prior to the effective date of this regulation, see subsection (f)(2) of Treas. Reg.* ~~***Sec.***~~ §*301.7701-3.*

*(B) Special rules. For purposes of subsection (b)(3)(A) of this regulation, a foreign eligible entity is treated as being in existence prior to the effective date of this regulation only if the entity's classification was relevant (as defined in subsection (d) of this regulation) at any time during the sixty months prior to the effective date of this regulation. If an entity claimed different classifications prior to the effective date of this regulation, the entity's classification for purposes of subsection (b)(3)(A) of this regulation is the last classification claimed by the entity. If a foreign eligible entity's classification is relevant prior to the effective date of this regulation, but no California* income tax, franchise *tax, or information return is filed or the California* income tax, franchise *tax, or information return does not indicate the classification of the entity, the entity's classification for the period prior to the effective date of this regulation is determined under the regulations in effect on the date prior to the effective date of this regulation.*

*(4) California classification of existing entities. (A) Notwithstanding subsection (c) of this regulation (related to requirement that an eligible business entity shall be classified or disregarded for California* income and franchise *tax purposes the same as the entity is classified or disregarded for federal California* income and franchise *tax purposes), an eligible business entity which, for any income year beginning within the sixty-month period preceding the effective date of this regulation, was properly classified as an association taxable as a corporation for California* income and franchise *tax purposes under Section 23038 of the Revenue and Taxation Code and the regulations thereunder, as in effect during such period, shall continue to be classified as an association taxable as a corporation until it irrevocably elects to be classified or disregarded for California* income and franchise *tax purposes the same* as *the entity is classified or disregarded for federal tax purposes.*

*(B) Election to be classified or disregarded the same as federal. 1. Election. An existing eligible business entity that, pursuant to subparagraph (A) of this subsection, is classified as an association taxable as a corporation for California* income and franchise tax *purposes for* taxable or *income years beginning on or after January 1, 1997, and, under Treas. Reg.* ~~***Sec.***~~ §*301.7701-3, is, without election, classified as a partnership or disregarded for federal tax purposes for taxable years beginning on or after January 1, 1997, may elect to be classified as a partnership or disregarded for California* income and franchise *tax purposes for taxable years beginning on or after the effective date of this regulation by filing an election to be classified or disregarded the same as the entity is classified or disregarded for federal tax purposes. An election under this subparagraph must be in writing, and will not be accepted unless all the information required by forms and instructions, including the taxpayer identification number of the entity and the information required by Sections 18633 or 18633.5 of the Revenue and Taxation Code, as applicable, is provided. See Treas. Reg.* ~~***Sec.***~~ §*301.6109-1 for rules on applying for and displaying Employer Identification Numbers.*

*2. Effective date of election. The election shall be effective on the date specified in the written election or on the date filed if no date is specified in the written election. Except with regard to an election filed within 90 days following the date* ~~***of enactment of SB 1234 (Regular Session 1997)***~~, this regulation is filed with the Secretary of State, *the effective date specified in the written election can be no more than 90 days prior to the date on which the election is filed and no more than 12 months after the date on which the election is filed. An election filed within 90 days following the date* ~~***of enactment of SB 1234 (1997 Regular Session )***~~ this regulation is filed with the Secretary of State *may specify an effective date of January 1, 1997.*

*3. Irrevocable election. If an eligible entity makes an election under paragraph (b)(4)(B) of this* ~~***section***~~ regulation *to be classified or disregarded the same for California* income and franchise *tax purposes as the eligible business entity is classified or disregarded for federal tax purposes, the election is irrevocable. However, the Franchise Tax Board, on a showing of fraud, mistake of fact, or other good cause, may permit the entity to rescind its election to be classified or disregarded for California* income and franchise *tax purposes the same as the entity is classified or disregarded for federal tax purposes.*

*4. Authorized signatures. An election made under paragraph (b)(4)(B) of this* ~~***section***~~ regulation *must be signed by each member of the electing entity who is an owner at the time the election is filed; or any officer, manager, or member of the electing entity who is authorized (under local law or the entity's organizational documents) to make the election and who represents to having such authorization under penalties of perjury. If an election under paragraph (b)(4)(B) of this* regulation ~~***section***~~ *is to be effective for any period prior to the time that it is filed, each person who was an owner between the date the election is to be effective and the date the election is filed, and who is not an owner at the time the election is filed, must also sign the election.*

*(c) Federal* tax *classification binding for California* income and franchise *tax purposes. (1) In general. Except as provided in subsection (b)(4) of this regulation, the classification of an eligible business entity for California* income and franchise *tax*

*purposes shall be the same as the classification of the eligible business entity for federal tax purposes under Treas. Regs. **~~Sec.~~** §301.7701-3. The election of an eligible business entity to be classified as an association or a partnership for federal* tax *purposes shall be binding for California* income and franchise *tax purposes. Except as provided in subsections (b)(4) and (c)(2) of this regulation, if the separate existence of an eligible business entity is disregarded for federal* tax *purposes , the separate existence of the eligible business entity shall be disregarded for purposes of Part 10 (Personal Income Tax Law commencing with **~~s~~**Section 17001), Part 10.2 (Administration of franchise and Income Tax Law commencing with **~~s~~**Section 18401), and Part 11 (Bank and Corporation Tax Law commencing with **~~s~~**Section 23001) of the Revenue and Taxation Code. An election to be disregarded for federal tax purposes shall be binding for purposes of Part 10 (Personal Income Tax Law commencing with **~~s~~**Section 17001), Part 10.2 (Administration of franchise and Income Tax Law commencing with **~~s~~**Section 18401), and Part 11 (Bank and Corporation Tax Law commencing with **~~s~~**Section 23001) of the Revenue and Taxation Code.*

*(2) Disregarded entities. Except as provided in subsection (b)(4) of this regulation, if the separate existence of an eligible business entity is disregarded for federal tax purposes, the separate existence of the eligible business entity will be disregarded for purposes of Part 10 (Personal Income Tax Law commencing with **~~s~~**Section 17001), Part 10.2 (Administration of **~~f~~**Franchise and Income Tax Law commencing with **~~s~~**Section 18401), and Part 11 (Bank and Corporation Tax Law commencing with **~~s~~**Section 23001) of the Revenue and Taxation Code, subject to certain statutory provisions which recognize the existence of otherwise disregarded entities for certain purposes including the tax and fee of a limited liability company under Sections 17941 and 17942 of the Revenue and Taxation Code, the return filing requirements of a* limited liability company *under Section 18633.5 of the Revenue and Taxation Code, and the credit limitations* of a disregarded entity *under Sections 17039 and 23036 of the Revenue and Taxation Code.*

*(3) Notification of federal election. An eligible entity required to file a California* income tax, franchise *tax, or information return for the taxable year for which an election is made under paragraph (c)(1)(i) of Treas. Reg. **~~Sec.~~** §301.7701-3 must attach a copy of its federal Form 8832* (or any successor form) *to its California* income tax, franchise *tax, or information return for that year. If the entity is not required to file a California* income tax, franchise *tax,* or information *return for that year, a copy of its federal Form 8832 must be attached to the California income tax, franchise tax, or information return of any direct or indirect owner of the entity for the taxable year of the owner that includes the date on which the election was effective. An indirect owner of the entity does not have to attach a copy of the federal Form 8832 to its return if an entity in which it has an interest is already filing a copy of the federal Form 8832 with its return. If an entity, or one of its direct or indirect owners, fails to attach a copy of a* federal *Form 8832 to its return as*
*directed in this section, an otherwise valid election under paragraph (c)(1)(i) of Treas. Reg. **~~Sec.~~** §301.7701-3 will not be invalidated, but the non-filing party may be subject to penalties, including any applicable penalties if the California franchise or income tax or*

*information returns are inconsistent with the entity's election under paragraph (c)(1)(i) of Treas. Reg.* ~~***Sec.***~~ §*301.7701-3.*

*(d) Special rules for foreign eligible entities--(1) For purposes of this regulation, a foreign eligible entity's classification is relevant when its classification affects the liability of any person for California* income tax, franchise *tax, or information purposes. For example, a foreign entity's classification would be relevant if California source income was paid to the entity and the determination by the withholding agent of the amount to be withheld under the Revenue and Taxation Code (if any) would vary depending upon whether the entity is classified as a partnership or as an association. Thus, the classification might affect the documentation that the withholding agent must receive from the entity, the type of tax or information return to file, or how the return must be prepared. The date that the classification of a foreign eligible entity is relevant is the date an event occurs that creates an obligation to file a California* income tax, franchise *tax,* ~~***return,***~~ or *information return, or statement for which the classification of the entity must be determined. Thus, the classification of a foreign entity is relevant, for example, on the date that an interest in the entity is acquired which will require a California person to file an information return.*

*(2) Special rule when classification is no longer relevant.--If the classification of a foreign eligible entity which was previously relevant for California* income and franchise *tax purposes ceases to be relevant for sixty consecutive months, the entity's classification will initially be determined under the default classification when the classification of the foreign eligible entity again becomes relevant. The date that the classification of a foreign entity ceases to be relevant is the date an event occurs that causes the classification to no longer be relevant, or, if no event occurs in a taxable year that causes the classification to be relevant, then the date is the first day of that taxable year.*

*(e) Coordination with* ~~***s***~~*Section 708(b) of the Internal Revenue Code. Except as provided in Reg. §23038(b)-2(d)(3) (regarding termination of grandfather status for certain foreign business entities), an entity resulting from a transaction described in section 708(b)(1)(B) of the Internal Revenue Code (partnership termination due to sales or exchanges) or* ~~***s***~~*Section 708(b)(2)(B) of the Internal Revenue Code (partnership division) is a partnership.*

*(f) Effective date--(1) In general. The rules of this regulation are effective for taxable or income years commencing on or after January 1, 1997.*~~***, provided, however, that none of the rules of this regulation shall apply until the effective date of SB 1234 (1997 Regular Session), as enacted.***~~

*(2) Prior treatment of existing entities. In the case of a business entity that is not described in Reg. §23038(b)-2(b) (1), (3), (4), (5), (6), or (7), and that was in existence prior to January 1, 1997, the entity's claimed classification(s) will be respected for all periods prior to January 1, 1997, if--*

*(A) The entity had a reasonable basis (within the meaning of* ~~***s***~~*Section 6662 of the Internal Revenue Code) for its claimed classification;*

*(B) The entity and all members of the entity recognized the California* income and franchise *tax consequences of any change in the entity's classification within the sixty months prior to January 1, 1997; and*

*(C) Neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination (in which case the entity's classification will be determined in the examination).*

*Note: Authority cited: Sections 19503 and 23038, Revenue and Taxation Code. Reference: Sections 17039, 17941, 18633.5, 23036, and 23038, Revenue and Taxation Code.*